An Alternative Approach to Allocation of Section 7(b)(3) Costs

BPA has identified an alternative approach to allocating Northwest Power Act section 7(b)(2) rate protection to non-preference loads through section 7(b)(3). Section 7(b)(3) states:

> Any amounts not charged to public body, cooperative, and Federal agency customers by reason of paragraph (2) of this subsection shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers. …

BPA's current approach is to allocate any 7(b)(3) amount *pro rata* based on loads of all other non-preference power sold, i.e., non-preference loads with adjustable rates including DSI sales at IP rates, Residential Exchange Program (REP) sales at PF Exchange rates, and New Resource sales at NR rates. Market-based sales such as firm surplus or secondary energy sold at FPS rates have not been allocated 7(b)(3) amounts.

This approach results in a single PF Exchange rate applicable to all exchanging utilities. Frequently, application of the current approach results in a PF Exchange rate that exceeds the Average System Cost (ASC) of lower cost utilities, thus eliminating such utilities from qualifying for REP benefits. For example, the WP-07 rate case resulted in a $16.37/MWh increase to the unbifurcated PF rate. This increase eliminated seven of eleven of the potentially qualified exchanging utilities.

An alternative approach would allocate the 7(b)(3) amount *pro rata* based on net exchange benefit amounts established before the section 7(b)(2) rate test. This approach would incorporate each utility's ASC in addition to its eligible REP load into the allocation. Under this approach, any utility that qualifies for REP benefits prior to the rate test would continue to qualify for benefits after the rate test.

The REP benefits for utilities that would receive benefits under this alternative but not under the current approach would come from reduced benefits for higher ASC utilities. One of the principles of the 1984 ASC Methodology was that the Methodology should give participating utilities an incentive to minimize their costs. This principle was never realized in the outcomes of either the ASC Methodology or the ratesetting process. The alternative allocation approach would increase comparative benefits for lower ASC utilities relative to higher ASC utilities and therefore better support the cost minimization principle than the current approach.

The alternative approach would not materially affect the amount of protection afforded to the preference customers, nor would it materially change the PF Preference rate after 7(b)(2) protection has lowered the rate. Due to the interrelationships between loads and costs, including the properties of the modeling and the discrete changes in loads and costs resulting from a utility being either in or out under the current approach, there may be slight differences between the PF Preference rates when comparing the two methodologies.

Another point in favor of this alternative is that it does not open the door for utilities to receive REP benefits that would not receive benefits in the absence of section 7(b)(2). A utility would still need

to qualify by having an ASC higher than the PF Exchange rate established prior to the rate test. Further, the alternative would not increase or decrease total net REP benefits. (Note: this statement is true theoretically, but actual results may slightly differ due to the relationship of different ratesetting inputs.)

The alternative approach would produce a different PF Exchange rate for each exchanging utility, i.e., utility-specific "supplemental rate charges" which would be added to the PF Exchange rate that was established before the rate test. This is a departure from past practice of establishing one rate for all exchanging utilities. Thus, there would be no PF Exchange rate established for new utilities applying for REP benefits between rate cases. This limitation could be addressed in REP rules which could state that to receive a Residential Purchase and Sale Agreement (RPSA), a utility would need to have an ASC determined, and the ASC Methodology could state that ASC would be determined only prior to rate cases. This would allow the pairing of the establishment of both the ASC and the supplemental rate charge for new exchanging utilities. It also would allow for the benefits to the new exchanging utility to be established in conjunction with the rate test, thereby minimizing the exposure of preference customers to unanticipated REP costs.

The alternative approach does not address how to allocate 7(b)(3) amounts to DSI or NR loads, which do not have ASCs and therefore no initial benefit allocator. This limitation might be solved by first allocating by loads to each rate class, and then allocate within the REP rate class according to the proposed approach. If no IP or NR loads exist, the supplemental rate charges for the IP and NR rates could be established by using the weighted average PF Exchange supplemental rate charge.